TRADE NEWS WEEKLY

January 21, 2020–January 24, 2020

A summary of international business news prepared by the Hawaii Foreign-Trade Zone 9 with the collaboration of the Research and Economic Analysis Division of the Department of Business, Economic Development & Tourism, and based on research and shipment data from Panjiva, Inc. which tracks companies involved in global trade. Other news sources may occasionally be included where indicated.

Burden Sharing Shifts as U.S. Import Price Deflation Slows

U.S. trade prices staged a rally in December with import prices rising 0.5% year over year, the first increase since March. Yet, that's been largely due to food and fuel price volatility with underlying import prices down 1.3%. The falling prices have largely been driven by imports from Asia, including China where deflation has remained constant at 1.8% throughout the fourth quarter.

The composition of deflation, in part reflecting burden sharing of tariffs between Chinese exporters and U.S. importers, has shifted somewhat. Import prices for footwear, where 15% tariffs were applied in September but will be cut to 7.5% in February, fell by 1.4% year over year versus a 0.6% slide in November.

For furniture, meanwhile, where tariffs were increased to 25% in May and won't be cut under the phase 1 trade deal, prices fell by 2.6% from 2.2% a month earlier. That's been offset in the aggregate by slowing price declines in industrial supplies – chemicals price deflation contracted to 5.5% in December from 6.6% in November.

USMCA - Senate Hurdle Cleared

The U.S. Senate has approved the implementing legislation for the U.S.-Mexico-Canada Agreement by 89 votes to 10 with one non-vote. The deal's completion just requires the Presidential seal, though ratification will depend on approval from Canada's Parliament. The Canadian Parliament will return to session on January 27. USMCA will likely formally enter into force on July 1, at which point the long process of industrial implementation will begin.

Mexico's deputy foreign minister, Jesus Seade, meanwhile has stated that Mexico should pursue closer trade relations with China. The desire to push for a trade deal is understandable from China's side, but a formal trade deal with Mexico could lead to the U.S. dissolving USMCA under the newly passed rules.

Shipping Rates Rebound After Phase 1 Deal

Global container shipping rates jumped 3.1% sequentially in the week to January 17, with China outbound rates having risen by 4.1%. The improvement was likely driven, in part, by continued absorption into rates of higher fuel costs. Ensuring that continues will be vital for the container lines' fortunes this year.

The phase 1 China trade deal also likely helped - though only a modest proportion of tariffs will be removed in February. Yet, some care is needed in interpreting weekly figures, particularly ahead of this week's Lunar New Year break.

Pharma Harvest from Phase 1 Deal May Be Transshipments

There has been a surge in interest from global pharmaceutical companies in China's single buyer program. The program, which sources generic drugs, has seen a 53% year over year drop in offered prices. It may provide a vehicle for China to meet part of its purchasing commitments made to the U.S. under the phase 1 trade deal.

U.S. pharma exports to China reached $4.1 billion in the 12 months to November 30 after rising 49.2% year over year. That growth would need to accelerate to 63.2% for each of 2020 and 2021 for pharma to contribute its proportionate share of China's commitment to raise its imports from the U.S. by $200 billion.

With China's total imports having reached $35.1 billion in the 12 months to November 30, after growth of 19.5%, there's certainly room for more supplies which historically have included shipments by Bristol Myers and Roche among others.

While displacement of supplies from Europe to China is a risk, most pharma companies are global and so could – in theory – transship via the U.S. to help China meet its commitments.

Other Winners from U.S.-China Trade Deal

The U.S. and China aren't the only winners from their phase 1 trade deal. Chile's Vice Minister of Trade, Rodrigo Yanez, has stated that "the phase 1 deal is good news for Chile" as most of the 7.6% year over year drop in Chile's exports in 2019 was due to reduced copper demand which, in turn, "is explained by copper pricing because of the trade tensions."

Chile's copper exports dropped by 20.2% in dollar terms and 7.0% in volume terms in November 2019. Exports to China fell by 17.4%, though a recovery is not guaranteed. Most U.S. tariffs remain in place, crimping the potential for a manufacturing recovery in China.

Among the major exporters of copper cathode – the largest export line from Chile – Codelco saw a 10.0% decline in global exports in the three months to November 30 while BHP's slipped by a more modest 2.0%.

Phase 1 Deal Means Toys Immune from China Tariff

The phase 1 trade deal between the U.S. and China has meant the toy industry will continue to be immune from tariffs. Yet, worries about their potential implementation led to stockpiling in the industry in 2019. There was a 16.6% year over year surge in U.S. seaborne imports of toys in 3Q followed by a 7.3% drop in 4Q.

In the case of Spin Master – maker of Owleez and Hatchimals – "the threat of U.S. tariffs and our increased inventory level" was one reason for an earnings guidance downgrade according to co-CEO, Ronnen Harary.

Spin Master continues to restructure despite the absence of tariffs with CFO Mark Segal stating that the firm is "continuing to diversify production outside of China." The share of shipments linked to the firm from China fell to 71.3% of the total in 2019 from 85.5% in 2018.

SPIN MASTER HATCHES ITS SUPPLY CHAIN REALIGNMENT PLAN

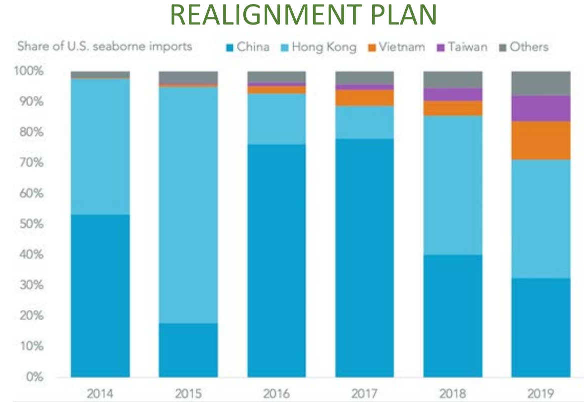

Chart segments U.S. seaborne imports associated with Spin Master by origin.
Source: Panjiva

President Trump Wants Change in WTO

President Trump has indicated that negotiations with the World Trade Organization leadership will occur within the next few weeks including suggestions for a "whole new structure." The discussions may include the future of India and

China's designations as "developing countries" under WTO rules.

The WTO's dispute settlement process has become effectively non-functional, leading several countries as well as the EU to look at alternative mechanisms. A solution seems unlikely in 2020.

Macron, Trump Talks Might Have Delayed U.S.-EU Trade Battle

The governments of France and the U.S. "will work together on a good agreement to avoid tariff escalation" regarding digital services taxes after a meeting between President Trump and President Macron. While official pronouncements have yet to be made, press reports suggest that will involve, (1) a delay in U.S. tariffs retaliating against the French DST until year end, and (2) France delaying payments of the DST until a wider OECD-level project is completed.

Further information may emerge after this week's meeting between Treasury Secretary Mnuchin and Finance Minister Le Maire. The latter has struck a somewhat cautious tone, saying that negotiations "remain difficult."

The EU implementation of digital services taxes is one major risk area for U.S.-EU relations. However, carbon border taxes remain unresolved and are arguably a larger issue given (1) French requirements that EU trade deals can only be done with Paris Agreement countries, and (2) the Trump administration's climate change skepticism and likely treatment of CBT as a trade distortion.

USMCA - Canada Most Likely Will Approve Trade Deal

The Trudeau administration will bring legislation to enact the U.S.-Mexico-Canada Agreement to Parliament from January 29. It is unlikely that Canada will reject the deal given previous bipartisan support. Yet, the opposition Conservative Party have indicated it will "definitely want to give it the proper due diligence to shine a light on some of the unique (aspects)," relating to dairy and aluminum. That may delay passage of the legislation.

Auto Tariffs and Digital Taxes Cloud U.S.-EU Trade Negotiations

Trade relations between the U.S. and EU remain on a knife edge between deterioration into a tariff war and improvement into a trade deal. The U.S. and France have "found a common framework to make progress towards a global solution on digital taxation," according to Finance Minister Le Maire after a meeting with U.S. Treasury Secretary Mnuchin.

That reduces the risk of tariffs linked to digital services, yet France "will not accept any withdrawal or suspension" of the tax while talks continue.

At the same time, President Trump has stated automotive tariffs are back on the agenda "if (the EU) don't make a deal that's a fair deal," before November. The situation regarding U.S. autos tariffs remains unclear. The U.S. Justice Department has ruled that the 2019 Section 232 investigation's conclusions should remain secret in order to avoid "impairing ongoing diplomatic efforts."

The risks to the U.S. autos industry may have been reduced after trade deals were signed with China, Japan, South Korea, Canada and Mexico covering 74.7% of U.S. parts imports and 76.7% of vehicles in 2019. The EU (excluding the U.K.) represented just 10.2% of parts and 16.7% of vehicles.

There's already been a 35.0% year over year slump in U.S. seaborne parts imports from the EU associated with Daimler in 4Q and a 13.4% slide in those linked to Volkswagen. In the meantime, there was also a 25.0% surge in shipments of parts to Mexico from the EU in the three months to November 30. There may be more to come given the U.S.-Mexico-Canada Agreement may be starting to influence supply chains.

ROT HAS SET INTO CAR PARTS IMPORTS FROM EUROPE IN 4Q

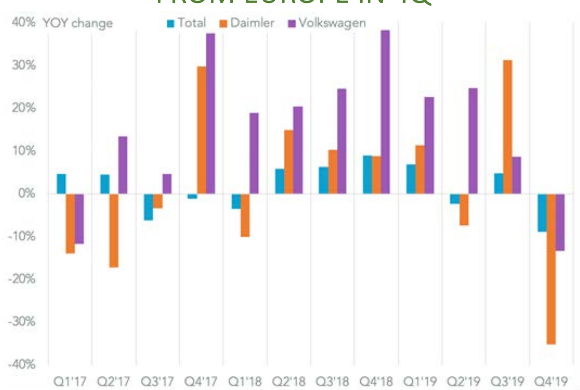

Chart segments U.S. seaborne imports of auto parts from the EU by shipper. Source: Panjiva

VF Corp's North Face Tariff Chill Set to Pass

Apparel manufacturer and brand owner VF Corp is in the middle of a strategic reorientation that has seen the firm exit from jeans and outlet stores as well as considering divesting of workwear to focus on brands including North Face and Timberland among others. It's also been beset by the U.S.-China trade war.

The firm's CFO, Scott Roe, has stated that "while tariffs not a big impact overall or even for the year, we do see, for the first time, a negative tariff impact in the fourth quarter." Meanwhile CEO Steven Rendle stated, "the recent Phase 1 trade deal between China and the U.S. should yield a more constructive consumer and retail environment."

The apparel industry has been subject to List 4A tariffs on imports from China at a 15% rate since September. The tariff rate will be cut to 7.5% from February, mitigating the impact on the apparel sector. It's also worth noting that the implementation of tariffs also came during the off-peak import season after winter clothing had already been shipped.

Brexit - Ready for Royal Signature

The British side of the Brexit process is now close to completion after the House of Commons finalized the bill, ready for signing by HRH Queen Elizabeth II. While finalization of the withdrawal deal on the EU side has to be voted on by the European Parliament, that looks set to be complete by January 31.

Importantly, that will allow an 11-month transition period during which future trade and other relations can be finalized. There's likely to be a focus on a short-form goods-only deal on the U.K. side, which the EU may be unwilling to accept.

Maersk Goes First on Fuel Fees

Container-line Maersk has applied one of the first bunker fuel adjustment increases of 2020, citing a surge in underlying fuel prices. Making that stick in terms of ensuring underlying rates don't fall will be key in showing that the liners have improved pricing power.

Meanwhile, the IMO has indicated that the January 1 move to new, low sulfur emission rules has seen a "relatively smooth transition" with 10 instances of fuel not being available as required.

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